

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Havice Analyst: Marion Mann DeJong Bill Number: AB 1611

Related Bills: SB 855 (1997/98) Telephone: 845-6979 Amended Date: 01/03/2000

SB 1045 (1997/98) Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Manufacturers' Investment Credit/Sales or Use Tax Paid for Property/Claims for Refund in Lieu of Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED _____ STILL APPLIES.

X OTHER - See comments below.

SUMMARY OF BILL

Under the Sales and Use Tax Law, this bill would amend the limitation on the amount of refund allowed to certain manufacturers for the purchase of qualified property.

SUMMARY OF AMENDMENT

The January 3, 2000, amendments deleted the provisions of the bill relating to the Manufacturers' Investment Credit (MIC) and replaced them with a Sales and Use Tax Law provision relating to the refund allowed to certain manufacturers for the purchase of qualified property.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment.

LEGISLATIVE HISTORY

SB 1811 (Ch. 547, Stats. 1994) added Section 6902.2 to the Sales and Use Tax Law to allow taxpayers to claim a refund for the sales or use tax that was paid on the purchase of qualified property, in lieu of claiming the MIC. The refund is limited to the amount of the taxpayer's MIC that could have been used to reduce income or franchise tax liability for the taxable or income year for which the refund is claimed. According to the sponsors of SB 1811, the bill was not intended to accelerate the rate at which taxpayers would be able to use the MIC to offset income taxes. Instead, it was intended to allow the California facilities of businesses that operate in multiple jurisdictions to demonstrate that expanding activity in California is cost effective. They argued that an

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	<u>X</u> PENDING

Department Director

Date

Alan Hunter for G.H.G

income tax credit claimed on the corporate tax return did not distinguish the facility that generated the credit from other lines of operation while a sales or use tax refund is credited to the facility within the context of the business's financial accounting of its operation.

SB 855 (1997/98) would have allowed a taxpayer in certain circumstances to claim a sales and use tax refund instead of the MIC.

SB 1045 (1997/98) would have allowed manufacturers of electronic computers to claim a sales or use tax refund of up to \$15 million, rather than claiming the MIC.

SPECIFIC FINDINGS

Current state Personal Income Tax (PIT) and Bank and Corporation Tax (B&CT) Laws allow qualified taxpayers engaged in specified manufacturing and related activities a credit equal to 6% of the qualified cost paid or incurred for qualified property that is placed in service in California. This credit is known as the Manufacturers' Investment Credit or MIC. MIC amounts not used in the current tax year may be carried forward for a maximum of eight years (ten years for small businesses as defined).

Current state Sales and Use Tax Law allows "new businesses" (as defined) that are manufacturers to claim a 5% exemption from sales and use tax instead of the MIC.

Current state Sales and Use Tax Law also allows a taxpayer to claim a refund for the sales or use tax that was paid on the purchase of qualified property rather than claiming the MIC. The refund is limited to the amount of the taxpayer's MIC that could have been used to reduce income or franchise tax liability for the taxable or income year for which the refund is claimed. If a taxpayer pays only the \$800 minimum franchise tax, then no sales or use tax refund is allowed.

Under the Sales or Use Tax law, this bill would amend the limitation on the amount of sales or use tax refund that is allowed for purchases of qualified property. The refund would be equal to the amount of allowable MIC for the year of the claim, not to exceed the actual sales tax paid or use tax accrued by the taxpayer, rather than the amount of MIC that could have been used to reduce income or franchise tax liability for the taxable or income year for which the claim is filed. Thus, a refund would be available even if the taxpayer paid only the minimum franchise tax for the year in which the refund is claimed and also would be allowed in an amount in excess of the taxpayer's franchise or income tax liability for the year the claim is filed.

Policy Considerations

This bill would raise the following policy considerations.

- This bill would allow a taxpayer without any franchise or income tax liability (other than the \$800 minimum tax) to claim a sales tax refund rather than carrying the MIC forward to succeeding years. This bill would allow taxpayers who have utilized other tax benefits to reduce their tax liability to the \$800 minimum tax to receive a refund of any unused MIC credit for the year that it was allowed but limited.

- When the MIC was originally enacted, a sales and use tax exemption for all manufacturing taxpayers for their costs of qualified manufacturing property was rejected by the Legislature as too costly. This bill effectively creates a sales and use tax exemption.
- This bill would propose a refund under the Sales or Use Tax Law for an income tax credit. This method is complex and may be difficult for taxpayers and both departments administering this proposal. It may be more appropriate to enact a sales and use tax exemption for all manufacturing taxpayers.

Implementation Considerations

- Although the department does not directly administer the refund currently provided under the Sales and Use Tax Law, the department does assist BOE with the refund process by verifying the amount of credit allowed under the MIC provisions that would be eligible for the sales or use tax refund. This process was established because there was no other way for BOE to verify the amount of the claim. It also was more effective since the department and not BOE administers the MIC and thus has expertise regarding the MIC. To date, BOE has received only a few refund applications and has allowed only one refund.

Under this bill, the volume of sale and use tax refunds would likely significantly increase since taxpayers that do not have sufficient tax liability to offset the MIC would likely request a refund. If the current process of verifying the amount of credit for the BOE is continued, the increased volume could potentially become a significant workload for the department. The department and BOE would need to establish procedures for verifying refund amounts and expand information sharing to prevent taxpayers from claiming more than one tax incentive.

Further, the department is finding significant compliance issues with the MIC. For example, taxpayers are claiming the MIC for property that is not qualified (e.g., furniture, exercise equipment, automobiles, office supplies, intangible property) and taxpayers that have business activities covered under other non-manufacturing divisions of the SIC Manual are claiming the credit (e.g., retail bakeries). Since this bill would allow a refund of the MIC amount, compliance may become a significant problem.

- It is unclear whether the taxpayer can claim the refund only on amounts on which they have paid sales or use tax, or whether the refund extends to amounts which qualify for the MIC under the capitalized labor provisions. If the capitalized labor amounts do not qualify for the refund, the taxpayer could claim a sale and use tax refund for the cost of the qualified property and claim the MIC for the capitalized labor costs, thus complicating administration of the proposed refund.

FISCAL IMPACT

Departmental Costs

This bill could create a significant workload for the department that would increase departmental costs. Until details of the department's involvement in the refund process are worked out with BOE and the author's staff, the actual costs cannot be determined.

Tax Revenue Estimate

The order of magnitude General Fund impact of this bill is projected to be as follows:

General Fund Impact of AB 1611 As Amended January 3, 2000 For Sales Taxes Paid After Enactment Only Assumed Enactment After 06/30/2000 (In Millions)		
2000-01	2001-02	2002-03
-\$245	-\$325	-\$325

Note: General Fund impacts above reflect sales tax refunds net of what would have been claimed as MIC credits under the income tax. Refunds are assumed to be paid after the close of respective income or tax years.

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Tax Revenue Discussion

The General Fund impact of this bill would be determined by the amount of qualified investment expenses incurred by certain manufacturers electing to claim sales tax refunds instead of carrying over MIC credits. Qualified investment was estimated from U.S. Department of Commerce data capturing annual capital expenditures. This amount was grown to the out-years by applying Department of Finance projected growth rates for corporate profits. This estimate assumes that capitalized labor costs would not be refunded but claimed as a MIC because sales tax is not paid on such amounts. Thus, all investment amounts were adjusted for capitalized labor directly associated with qualified investment. The next step was the identification of companies that would file a claim for refund in lieu of claiming the MIC credit allowed by Section 17053.49 or 23649 of the Revenue and Taxation Code. Based on tax return information, it is assumed companies that are unable to use all of their generated credit in any given year would file a claim for sales tax refunds in lieu of the MIC credit.

BOARD POSITION

Pending.